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(IR)RESPONSIBLE LENDING AND PERSONAL INDEBTEDNESS: CONSUMER CREDIT MARKETING

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ABSTRACT

The problem of personal over-indebtedness is escalating in the last decade in spite of the various regulatory changes being imposed both on the level of European Union and within national regulations. Most of the research and policy have been directed towards mitigation of irresponsible borrowing. Considering the disappointing results of such policies (ever growing number of over-indebted households), this research points to the neglected problem of irresponsible lending practices of the financial industry actors. This direction of research is additionally supported by previous research findings: consumers perceive banking sector as responsible for debt problem, and believe that they act unethically when promoting the easy access to credit. Responsible lending practices span across broad range of lenders´ activities: from information disclosure in pre-contractual stage, creditworthiness assessment to impartial counseling in case of difficulties in repaying debt, just to name a few. This research is focused on the problem of adequate information provision to consumers through marketing activities of principal credit providers. Prior to the field research, desk research of the existing regulation on information disclosure in the advertisement stage of the consumer credit is carried out. The next method applied is content analysis of advertising tools in Croatian financial sector and comparison of the results within European Union. Analysis entails two aspects of advertising content compliance with national legislation and European consumer credit directive (CCD): first, quantity of information disclosed and second, quality of information disclosed.

Due to the small credit market and scarce number of specialist lenders the analysis is contained to the banking sector which covers vast majority of consumer credit agreements. Results show that compliance of bank marketing efforts, both quantitative and qualitative, with the information requirements at the advertisement stage is extremely low. That gives evidence to the claim that banks engage in irresponsible lending practices and therefore show very low level of corporate social responsibility. Results also indicate that adequate supervision of the analyzed bank lending practices by responsible regulatory bodies is completely missing.

Keywords: *Bank Marketing, Personal Over-indebtedness, Responsible Lending*

1. INTRODUCTION

Banks as financial institutions are continuously involved in growing problem of personal indebtedness by aggressive bank marketing in the area of bank products supply. The goal of this paper is to present existence of (ir)responsible lending on example of consumer credit advertising. Evidence about personal indebtedness trends is presented and the impact of irresponsible lending practices through aggressive bank marketing is analyzed. Empirical part of research is focused on information content of various types of advertisements in the field of personal loans and credit cards and their compliance with EU legal framework. Croatian position among EU Countries from the quantitative and the qualitative compliance aspect is determined and evaluated.

2. THE ROLE OF BANKS IN THE GROWING PROBLEM OF PERSONAL INDEBTEDNESS

The responsible behavior of banks is a feature that enables them to conduct long-term sustainable business. Research evidence (Ennew, Sekhon, 2015) shows that key drivers of such behavior are integrity, consistency, benevolence, expertise and competence. Business practices stemming from such behavior enable consumers to confidently make complex financial decisions knowing that banks are concerned about their interests and are trustworthy in preventing adverse course of events (e.g. default). But the data about trust in universal banks is deteriorating: in the 1970s 60% of Americans trusted big banks “a great deal”, and by 2012 only 21% did so (Hurley, Gong, Waqar, 2015). As the matter of fact Australian research suggests that consumers hold banks responsible for the debt problems and believe that they behave unethically in promoting the easy availability of credit. Consumers also think that banks need to elevate their ethical standards since their decisions greatly affect livelihoods of their customers (Fear, O’Brien, 2009).
Another important aspect that should lead to transfer of responsibility for personal indebtedness to banks founded in research (Puttonen, 2015) considers mental shortcuts that consumers use when dealing with complex decision-making in finances. These include: simplification of financial decision data due to limited cognitive capacity for complex computations, non-objectiveness and irrationality due to emotionally guided decisions, and uninformed decisions due to insufficient consumer knowledge and motivation. Banks should be also motivated to behave responsibly since contributing to the rising social problem of over-indebtedness is in contrast to their publicly strongly proclaimed corporate social responsibility agenda. Research also adds evidence on strong positive relationship between corporate social responsibility of banks and their financial performance (McDonald, 2015). Unfortunately, other research (Mulki, 2015) demonstrates that there is no empirical evidence that ethics in banking helps improve their financial performance. Therefore it can be seen that there are inconsistencies in research results, mainly attributed to adverse impact of employee’s performance-linked compensation which is a strong driver for their unethical behavior.
Banks are the most prominent institutions of the whole financial system and are principal agents in creation of the credit market supply. Changing circumstances on the financial market (deregulation and ever-rising possibilities given by sophisticated, industry specific information technologies) led to increased competition and credit availability. Banks try to manage change, achieve growth and profitability regardless of the negative outcomes in the household sector – exponential growth of indebtedness. In his research Ramsey (2012) labeled over-indebtedness as a significant social and economic issue that disproportionately affects lower income groups (for example in 2010 majority of French debtors had net revenues less than the minimum wage). He concludes that the law of over-indebtedness may symbolize the breakdown of social and family sources of solidarity and the rise in inequality associated with neoliberalism. The data supporting the troublesome trends described above is presented in the next section.

2.1. Personal indebtedness trends: evidence worldwide

The problem of insolvent households has spread around the world. There are the measurement of different aspects of this problem area is not uniform, and it varies mostly due to the different regulatory framework and definitions of over-indebtedness. Nevertheless, the trend of significant increase in personal indebtedness is discernable from them all.
In the USA the personal bankruptcy rate has increased three times in twenty years (Livshits, 2015, 597). The trend has lost some momentum due to the crisis resolution in the past four years. Total number of bankruptcy filings in 2016 was 794.960 with share of non-business (personal) filings of 97% (United States Courts, 2017). Driven by favorable loan conditions and aspiration to maintain living standard American middle class had increased borrowing despite

non increased income (Attali, 2009). In the United Kingdom individual bankruptcies increased from about 9.000 in 1989 (Ramsey, 2012, 237) to about 16.000 in 2015 (Gov.UK, 2017), the share of consumer bankruptcies also rose from 39% in 1990 (Ramsey, 2012, 237) to 84% in 2015 (Gov.UK, 2017). This can be attributed to the fact that number of consumer credit in the UK had doubled since 1980s. Data from France reflects similar situation: the number of applications to the over-indebtedness commissions (specific French government institutions) rose from 1,6 per thousand capita in 1991 to 3,3 per thousand capita in 2015 (Banque de France, 2016).

The most frequently used metric of the household levels of indebtedness is consumer credit to disposable income. Data (Vandone, 2009) shows broad differences between EU countries: from 25,5% in the UK to 3,6% in Slovakia. More developed countries have above average ratio (e.g. Ireland 19,9%, Denmark 15,6%, Germany 15,1%, Spain 14,9%, Austria 14,5%), whereas Eastern European countries show extreme consumer credit growth rates due to still limited diffusion of consumer credit (e.g. Lithuania 424%, Estonia 285%, Latvia 165%, Hungary 156%, Slovakia 119%). Overall Euro area consumer credit almost doubled in the past twenty years: from 360 bn EUR in 1997 to 617 bn EUR in 2017 (Trading Economics, 2017). Levels of non-performing household loans show significant increase (Kempson, 2015, 142). In 2007 all EU countries were below 5% whereas by 2013 ten countries were above 10% share of non-performing household loans. Those were either countries with immature credit market (Romania, Bulgaria, Slovenia, Lithuania and Croatia) or countries hit hard by recession (Greece, Cyprus, Ireland, Portugal and Italy).

Croatian data show similar patterns. The structure of loan allocation by banks has changed in favor of household debt and on account of corporate debt. In 1994 household loans had share od 28,8% (Družić, 2001), and in 2015 45,6% (Croatian National Bank, 2016a). Such shift insures growth and development banking business which causes a significant increase of personal debt. In the similar period (1981-2011) population fell 7% (Croatian Bureau of Statistics, 2016) causing even stronger rise of per capita indebtedness. Non-performing household loans share in total loans has been steadily rising from 4% in 2008 to 12% in 2015 (Croatian National Bank, 2016c). Most notable expression of personal over-indebtedness in Croatia can be seen in significant rise of debt on personal frozen accounts (specific Croatian phenomenon depicting heavily indebted individuals): from 16,31 bn kuna in 2012 to 41,65 bn kuna in 2017 (more than 2,5 times), majority - 57% of their debt is to the financial sector. Most of the individuals with frozen accounts (81%) have been in that situation continuously for longer than one year. In February 2017 there were more than 327.000 persons with frozen accounts and they represent 11% of working-age population (Financial Agency, 2017). Described trends in Croatia fit into the wider spread trends of rising personal indebtedness.

The link between advertising, credit and consumption has been empirically examined on US aggregate time series data (Lamdin, 2008) and results show that variables: advertising and credit can be interpreted as causing consumption. These important results and data presented justify focus of this research to be directed towards bank marketing and its link to indebtedness.

2.2. Aggressive bank marketing: impact of irresponsible lending practices on personal debt

In explanation of over-indebtedness issues much of the previous research applies individualistic approach with psychological underpinnings, i.e. sees reckless borrowing and consumerism as main drivers of the problem. The recommendations and solutions are mainly suggested in the area of financial literacy empowerment, with financial sector out of the research agenda. The recommendations are not put in practice which is backed with data on very uneven exposure of consumers to financial information: US financial industry marketing budget is 25 times larger than financial education budget (670 million vs 17 billion dollars annually) (CFPB, 2013).

Action taken so far has been directed towards bailing out banks and stabilizing the economy rather than helping the individual consumer (Micklitz, 2015, 231). Even though the problem has been officially recognized by all institutions, research (Domurath, 2015) argues that in EU legal order; specifically consumer law refers to responsible lending only in a narrow way, therefore missing the opportunity to contribute to the prevention of personal over-indebtedness. Narrow concept entails only (Vandone, 2009, 76) information disclosure and transparency, appropriate creditworthiness and total exposure assessment. Broader concept would necessarily include (Domurath, 2015) lender liability, financial product regulation, impartial advisory services and safe financial inclusion. It is only logical that more informed and more competent agent (lender / bank) should be attributed with more decisive, but transparent and fair position in the lending process (*ex ante* and *ex post*). Consequently, it is the lender to whom also more direct responsibility for lending outcomes should be transferred to. Mainstream research community (Vandone, 2009) considers this shift to be unrealistic due to the nature of financial intermediaries since they evaluate the impact that a loan may have on their balance sheets, but do not consider possible negative externalities generated from granting of a loan on households' well-being. Such conceptualization of responsible lending practices implies *status quo*. Here the broader approach is taken and is considered as necessary in attempt to thoroughly redirect regulation efforts towards financial sector and substantially change policy agenda when coping with problem of personal over-indebtedness.

Banking industry deregulation and increase competition in credit markets had an adverse effect on consumer default: expansion of the availability of credit leads to the expansion of the supply of consumer credit and rising personal bankruptcy rates (Dick and Lehnert, 2010). In order to increase significantly profits and market share banking industry increased spending on marketing activities (Mullineaux and Pyles, 2010). As a routine practice in financial sector credit limit has been freely used as a tactical marketing tool for years now. For example when credit card users with good payment record reach their limit, their credit line is typically increased (Punch, 1992) which causes a significant rise in debt (Gross and Souleles, 2002). This makes credit limit an aggressive marketing tool rather than a measure of credibility. The practice of telling consumers that they ‘‘deserve’’ increases in their credit limits are not only non-informative but might also mislead consumers into believing that their projected future net worth has actually increased.

Marketing content can be shown as a powerful tool of future financial engagements of consumers and therefore of special interest for banks trying to add more value to their services and increase profits. By development and improvement of consumer experience and different advertisements and promotion techniques follow the innovative way of thinking and show the ideas in the content. A scientific direct mail marketing field experiment conducted in South Africa (Bertrand et al., 2010) tried to determine how much or how various marketing content techniques affect demand for credit. The results showed that specific marketing content oriented to consumers, in this case a photo of an attractive woman, increases consumer loan demand by about as much as a 25% reduction in the interest rate. Therefore, it has been proven that effective marketing content is as powerful as the interest rate level in deciding upon getting a credit (Filipović, Škalamera-Alilović, Štambuk, 2016). These results show that banking advertising and promotion costs are successful tools of boosting consumption and consequently an active agent of the worsening problem of personal over-indebtedness worldwide.

3. IRRESPONSIBLE BANK ADVERTISING: CROATIA AND EU

Research on consumer attitudes to over-lending indicates (Fear, O'Brien, 2009, 6) that advertising encourages people to spend more than they earn (79% of respondents agreed) and that banks are too willing to lend people more than they can afford to repay (73% of respondents agreed) which forms a strong belief that lenders and regulators, rather than individual consumers, are responsible for the debt situation. EU regulator, aware of worrisome trends and of important role of financial institutions and their lending practices that boost instead mitigate that problem, has designed consumer protection framework incorporated in Consumer Credit Directive (CCD) (European Commission, 2008). Regulation of advertising information content is covered in Article 4. Coverage of this article is very narrow because it excludes any advertising not including "figures relating to the cost of credit". At first Croatian regulator when implementing CCD into national legislation just copied CCD requirements (Zakon o potrošačkom kreditiranju, 2009). But, three years later, obviously aware of the loophole strategically used by banks to circumvent disclosure of standard information, opted for more stringent framework and applied obligatory standard information for all advertisements regardless of whether they contain figures on the cost of credit or not (Zakon o izmjenama i dopunama Zakona o potrošačkom kreditiranju, 2012).

In 2013 European Commission received Final report on the Study on the Functioning of the Consumer Credit Market in Europe which they ordered from Ipsos and London Economics. The results of this Study indicated very poor level of CCD implementation across EU. Research presented in this paper adds Croatian data and compares it with other EU countries.

The main hypothesis is that even though the regulation is more stringent, due to the lack of institutional capacity in regulatory implementation and control, irresponsible lending measured by aggressive bank advertising (non-compliant with the law) is more prevalent in Croatia than in other EU countries.

Two auxiliary hypotheses are developed: (1) Compliance of Croatian bank advertisements with the set of information requirements (measured by CCD compliance index) is worse compared to the other EU countries; and (2) Quality of Croatian bank advertisements (measured by advertisements performance index) is lower compared to the other EU countries.

3.1. Sample and methodology

During the period of one month all of the available banking advertising materials covering personal loans and credit cards in Croatia were gathered. These field activities resulted in a sample of 53 advertisements. Comparison with the EU results is based on the data available from the research performed by Ipsos and London Economics (2013), which did not include Croatia. The structure of the Croatian sample is presented in the following table.

Table 1: Croatian sample of bank advertisements (Authors' calculations)

Type of advertisement	Total	Personal loan	Credit card
Radio and TV	8	8	
Newspapers and magazines	1	1	
Flyers	25	17	8
Posters	3	3	
Other non-web (display, mail)	6	6	
Web	10	6	4
Total	53	41	12

The structure of the sample reveals that banking sector advertising efforts are more strongly directed toward personal loan segment (77%) than to credit card segment (23%). Flyers and web instruments are more heavily represented as these advertising instruments do not largely depend on marketing campaigns schedule and are always readily available. The sample

included advertising materials from nine Croatian banks[1]. Credit portfolio of banks included (221,7 bn kuna) represents vast majority (88%) of total loan market in Croatia (251,2 bn kuna) (Croatian National Bank, 2016a, 2016b). Croatian sample included only banks since specialized lenders market is very underdeveloped and represents an insignificant part of total loan market (e.g. value of leasing market in 2015 is only 3,6 bn kuna (HANFA, 2016)).
Methodology for this study has been aligned with Ipsos and London Economics (2013) in order to be able to perform benchmarking of the Croatian results with the other 27 EU member states. The method of composite index has been applied on both research questions. First, the CCD compliance index has been calculated based as the ratio of the number of criteria per advertisement fulfilled to number of criteria prescribed (8 for personal loan, and 6 for credit card advertisements). Second, the performance index is based on the assessment carried out by researchers whether the advertisement information is or is not clear, prominent and concise, as prescribed by CCD. The scores for 3 quality dimensions and 2 loan types were aggregated and averaged to form unitary performance index. Limitation of the benchmarking exercise reflects the fact that quality assessment as subjective measure has been done by different experts so that Croatian results may be downward or upward biased compared to EU results due to that fact.

3.2. Results and discussion

The first set of results refers to the research question of advertisement information compliance with the standard information framework set out in Article 4 of CCD. Information requirements differ somewhat according to the type of loan: there are 8 obligatory criteria for personal loan and 6 for credit card loan. The results of compliance by information content criteria for Croatian sample are represented in Table 2.

Table 2: CCD compliance by information content (Authors' calculations)

Information requirement	**Personal loan**		**Credit card**	
	Frequency	Percentage	Frequency	Percentage
Borrowing rate	17	41	0	0
Rate fixed or variable	22	54	0	0
Other charges	17	41	6	50
Total credit amount	23	56	2	17
APR	17	41	0	0
Duration of agreement	15	37	x	x
Total amount payable	13	32	0	0
Number of instalments	6	15	x	x

The results show that overall compliance is very law and considerably lower for credit card then for personal loan advertisements. Only 3 criteria are disclosed in 50% or more advertisements (whether the rate is fixed or variable – 54%, and total credit amount – 56% are present in personal loan advertisements and information on other charges are present in 50% of credit card advertisements). The other noticeable result is that 3 out of 6 financial information required are not present in any of the credit card advertisements.
Disaggregating of the results according to the number of the criteria met per advertisement reveals another problematic aspect in distribution of the results, shown in Table 3.

[1] Zagrebačka bank, Privredna bank, Erste bank, Reiffeisen bank, Addiko bank, Splitska bank, HPB bank, SBER bank and Podravska bank.

Table 3: CCD compliance by the number of criteria met (Authors' calculations)

Number of information criteria met	Personal loan		Credit card	
	Frequency	Percentage	Frequency	Percentage
8	3	7	x	x
7	5	12	x	x
6	7	17	0	0
5	2	5	0	0
4	0	0	0	0
3	1	2	0	0
2	6	15	2	17
1	4	10	4	33
0	13	32	6	50

The distribution of the disclosed information per advertisement is not normal, i.e. the results cluster around upper and lower end (personal loan) and lower end only (credit card). That means that average data in previous table should further be explained. Namely, 36% of personal loan advertisements disclose relatively high number of information (8, 7, 6), and 37% relatively low number of information (2, 1, 0). Therefore, relatively higher averages in Table 2 for personal loan are due to the fact that there are several highly compliant advertisements which pull the average results up.

The next Table shows the compliance results by the type of media used.

Table 4: CCD compliance by the type of media (Authors' calculations)

Type of media	Compliance index
Radio and TV	5
Newspapers and magazines	0
Flyers	50
Posters	33
Other non-web (display, mail)	6
Web	35
Overall	33

Flyers score the best (even though with the relatively law result of only 50% compliance) which can be easily explained by the format that allows presenting large quantity of information and are always readily available in every bank. Still, CCD regulation does not differentiate media types in any way and therefore the same requirements apply to all types of media. The most striking result is extremely low compliance of 5% on radio and TV advertisements, bearing in mind that especially TV commercials reach far greater number of potential consumers than any other type of media. Overall CCD compliance index for personal loan advertisements is calculated for Croatia and compared with the results of other EU countries (Chart 1).

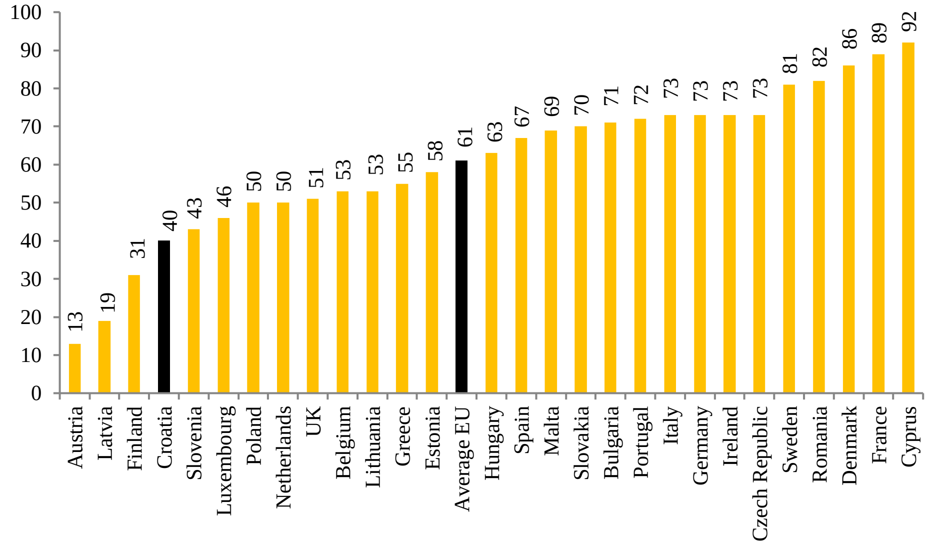

Chart 1: Personal loans advertisements CCD compliance index
(Authors' calculations based on research data and
data from Ipsos and London Economics, 2013)

Data presented above shows poor CCD compliance across EU. The average score is just 61% of necessary information content disclosure in personal loan advertisements. The results are widely spread apart and vary from extremely low 13% in Austria to almost full compliance (92%) in Cyprus. No EU country fully complies with CCD advertisement requirements regarding personal loans. Croatian result (40%) ranks 25/28 and scores 21 percentage points below EU average, and can be therefore qualified absolutely and relatively very poor.

Credit cards advertisements CCD compliance data is presented by following chart.

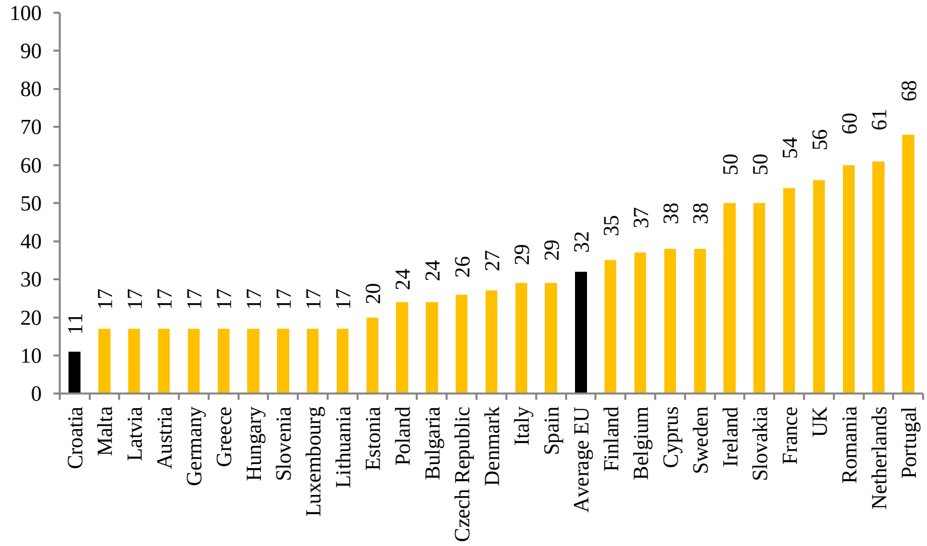

Chart 2: Credit cards advertisements CCD compliance index
(Authors' calculations based on research data and
data from Ipsos and London Economics, 2013)

Overall results are significantly worse for credit cards, even though the absolute number of information disclosure requirements for credit cards (6) is lower than for personal loans (8). The average EU credit card compliance is 32% which is almost two times lower than personal

loans index. Highest scoring country is Portugal with an index of only 68%. Croatia is positioned at the bottom of the list with the worst result: on average in Croatian credit card advertisements almost 90% of the required information content is missing.
EU average for both loan types is 46%, and Croatia's 25%. This leads to the conclusion that the goal of consumer credit protection in the area of advertising is far from being soon achieved. The results of this research clearly detect that problem area of consumer protection in financial sector lies not in legislative phase, but in implementation control and sanction phase of regulation. Therefore the authors are of the opinion that the adequate solution would not be to pursue this form of regulation since it brought very modest results since its inception (2008). Authors rather suggest that in circumstances of heavy and growing societal problem of personal over indebtedness, complete ban of advertising in financial sector would be a measure easier to implement and control.
The second set of results refers to the three required qualitative dimensions of consumer credit advertising: clarity, prominence and conciseness. All advertisements were scored with "yes or no" meaning either the information was clear, prominent and concise, or not. Each of the quality dimensions is assessed separately and index is formed as an average of the scores of each dimension. Performance index therefore measures the overall quality of consumer credit advertisements on the scale from zero to one hundred. In case of Croatia 15% of advertisements were assessed as clear, 64% as prominent and 38% as concise. Performance index is the average of all three dimensions results, and can be interpreted as quality performance index 39. The following chart benchmarks Croatia to the rest of EU countries.

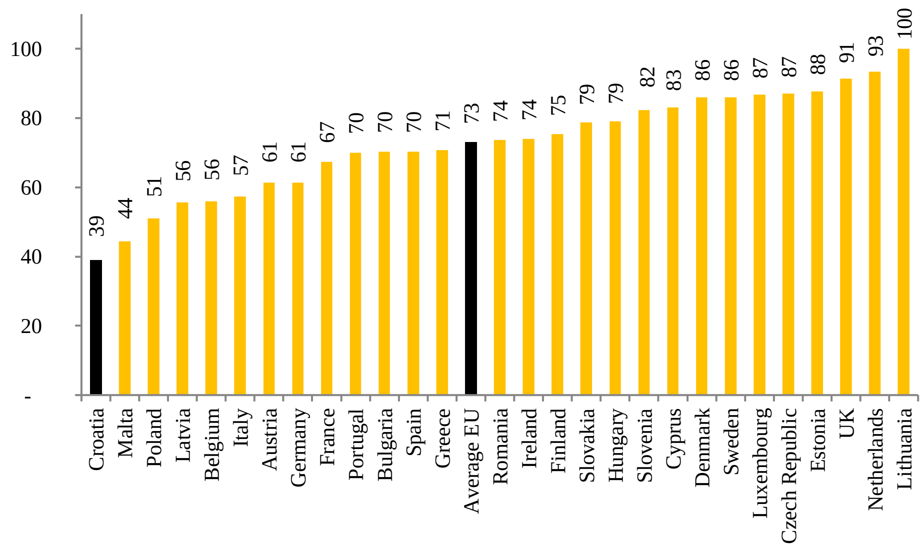

Chart 3: Advertisements performance index (Authors' calculations based on research data and data from Ipsos and London Economics, 2013)

In the interpretation of the above results it is certain that they are biased upwards by the mere fact that assessment was done by experts who are financially highly literate, so if the assessments were done by average consumer the scores would be lower. This is the reason why above results should be interpreted only in relative terms. Croatia score is the worst, and Lithuania score is the best. The spread between the minimum and maximum of the performance index is smaller than of the compliance index.

Spearman's rank correlation coefficients were calculated to determine if the observed indexes within a sample of countries show consistent patterns. The results show that there is moderate level of relation in countries' rank in personal loan and credit card compliance index (0,45), low level of rank relation between credit card compliance index and performance index (0,29) and that there is no relation between personal loan compliance index and performance index (0,06) of EU countries. The conclusion drawn is that the phenomena researched vary considerably between and within EU countries. But specifically Croatia's results are consistently at the low end: credit card compliance index and performance index being the worst in the EU, and personal loan compliance index positioned on the 25th place.

4. CONCLUSION

Research results undoubtedly present reckless lending practices in bank advertising of personal credit instruments. Even the narrowly conceptualized regulation of consumer credit protection is poorly implemented and irresponsible behavior of banks is obvious. Conclusion can be drawn that little has been done in allocating responsibility for indebtedness to the lender.

The upcoming research efforts should be directed to further develop more rigorous attempts to model the relationship between personal over-indebtedness and banking industry operations, in order to provide evidence for significant regulator policy changes. Regulation changes that are here advocated for are: more specific regulation about banking industry operating procedures to align them with broader concept of responsible lending practices. EU and national regulators should engage more in protection of consumers in financial industry; even consider extreme measures such as banning of bank marketing with intention of pursuing more aggressive and efficient ways in preventing and diminishing dangerous levels of personal indebtedness.

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